



# Report of the auditor-general to the North West provincial legislature and the council on the City of Matlosana

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the City of Matlosana set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP), the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (DoRA) and for such internal control as the accounting officer determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified opinion**

### **Revenue**

6. As per GRAP 9 *Revenue from exchange transactions* and GRAP 23 *Revenue from non-exchange transactions*, all revenue due should be recognised and measured reliably. The municipality did not record all sewer related revenue and recorded revenue from property rates using incorrect tariffs. Consequently, services charges of R1 309 265 825 and property rates of R272 706 788 included in revenue recognised in the statement of financial performance, were understated by R10 158 121 and R17 210 596 respectively, whilst consumer debtors in the statement of financial position was understated by R27 368 717. Additionally, there was a resultant impact on the deficit for the year and the accumulated surplus recognised in the financial statements.

### **Irregular expenditure**

7. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments of R 40 744 985 in contravention of the supply chain management requirements, which were not included in irregular expenditure disclosed. Consequently, irregular expenditure of R2 081 326 943 disclosed in note 44 to the financial statements is understated by R40 744 985.

## **Qualified opinion**

8. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the City of Matlosana as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with the SA standards of GRAP and the requirements of the MFMA and the DoRA.

## **Emphasis of matters**

9. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Unauthorised and fruitless and wasteful expenditure**

10. As disclosed in note 42 to the financial statements, unauthorised expenditure of R73 697 807 was incurred in the current year and the unauthorised expenditure of R1 424 534 175 in respect of prior years had not yet been dealt with in accordance with section 32 of the MFMA.
11. As disclosed in note 43 to the financial statements, fruitless and wasteful expenditure of R23 264 026 was incurred in the current year and fruitless and wasteful expenditure of R91 222 464 from prior years had not yet been dealt with in accordance with section 32 of the MFMA.

### **Material impairments and distribution losses**

12. As disclosed in note 32 to the financial statements, the municipality incurred water and electricity losses of 29% (2015: 36%) and 25% (2015: 27%) respectively. In addition, impairments of R480 063 289 (2015: R268 834 486) incurred as a result of significant impairment of debtors are disclosed in note 26 to the financial statements.

## **Restatement of corresponding figures**

13. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2016 in the financial statements of the City of Matlosana at, and for the year ended, 30 June 2015.

## **Going concern**

14. The statement of financial performance indicates that the City of Matlosana incurred a net loss of R308 282 393 during the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R347 979 954. These conditions, along with other matters as set forth in note 40, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

## **Material under spending of the grant**

15. As disclosed in note 21 to the financial statements, the municipality need to surrender back to National Treasury an amount of R21 894 596 (2015: R36 780 267) due to non-spending of the Municipal Infrastructure Grant (MIG) allocations for infrastructure projects, the Integrated National Electrification Programme (Eskom) (NERSA) and the Expanded Public Works Programme Integrated Grant for Municipalities (EPWP). As a consequence, the municipality was unable to adequately fulfil its mandate on these projects.

## **Additional matters**

16. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## **Unaudited supplementary schedules**

17. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

## **Report on other legal and regulatory requirements**

18. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## **Predetermined objectives**

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2016:
- Key performance area 1: Basic service delivery and infrastructure development on pages X to X
20. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned key performance area. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme

performance information (FMPPI).

21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. I did not identify any material findings on the usefulness and reliability of the reported performance information for the selected key performance area of the municipality.

## **Additional matters**

23. Although I identified no material findings on the usefulness and reliability of the reported performance information for the selected key performance area, I draw attention to the following matters:

## **Achievement of planned targets**

24. Refer to the annual performance report on pages XX to XX and XX to XX for information on the achievement of the planned targets for the year.

## **Adjustment of material misstatements**

25. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for key performance area 1: Basic service delivery and infrastructure development. As management subsequently corrected the misstatements, I did not identify any material findings on the usefulness and reliability of the reported performance information.

## **Compliance with legislation**

26. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Annual financial statements and annual reports**

27. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements on non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records provided, but the uncorrected material misstatements on revenue and irregular expenditure resulted in the financial statements receiving a qualified audit opinion.

## **Expenditure management**

28. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
29. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Consequence management**

30. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.



31. Allegations of financial misconduct against senior managers were not always tabled before council, as required by regulation 5(2) of the disciplinary regulations for senior managers.

## **Human resource management and compensation**

32. Sufficient appropriate audit evidence could not be obtained that job descriptions were established for all posts in which appointments were made in the current year, as required by section 66(1)(b) of the Municipal Systems Act, 2000 (Act 32 of 2000) (MSA).
33. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate the performance of staff, in contravention of section 67(d) of the MSA.

## **Procurement and contract management**

34. I could not obtain sufficient appropriate audit evidence that all contracts were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as information was not presented on time for audit.
35. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulations 17(a) and (c).
36. I could not obtain sufficient appropriate audit evidence that goods and services with a transaction value above R200 000 were procured by inviting competitive bids, as required by SCM regulation 19(a).
37. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
38. Awards were made to providers who are in the service of other state institutions or whose directors and principal shareholders are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
39. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality, failed to disclose such interest, in contravention of SCM regulation 46(2)(e).
40. I could not obtain sufficient appropriate audit evidence that contracts were only awarded to providers whose tax matters had been declared to be in order by the South African Revenue Service, as required by SCM regulation 43.
41. I could not obtain sufficient appropriate audit evidence that measures to combat the abuse of the SCM system were implemented as required by SCM regulation 38(1).

## **Environmental management**

42. The municipality did not exercise its legislative and executive authority of managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment, as required by section 11(3)(l) and (m) of the MSA.
43. The municipality operated its wastewater treatment facilities without a license in contravention of section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
44. The municipality's operational activities at its waste disposal sites and wastewater treatment facilities contravened or failed to comply with the requirements of a waste management license or the norms and standards as prescribed by sections 67(1)(f) and (h) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA) and sections

151(1)(c) and (i) of the NWA.

45. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.

## **Internal control**

46. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion and the findings on compliance with legislation included in this report.

## **Leadership**

47. The leadership has not been able to enforce a culture of honesty, ethical business practices and good governance. Although there were resolutions adopted by council to address prior year audit findings, the implementation thereof was mostly done through consultants with limited transfer of skills to own staff.
48. Effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored, was not implemented. An effective organisational structure for placing appropriately skilled people is not in place. There was a lack of continuity in key management positions due to suspensions and resignations, leading to these positions being filled by acting officials.

## **Financial and performance management**

49. The municipality did not implement a proper record keeping system to ensure that complete, relevant and accurate information is accessible and readily available to support financial reporting and compliance with laws and regulations.
50. Management's continuous failure to comply with laws and regulations as well as their inability to implement controls to ensure reliable and accurate financial reporting, is a concern. This factor, as well as the continuous non-adherence with the council's supply chain management policy without consequences, reflects negatively on management's commitment towards a clean administration.

## **Governance**

51. Management do not have an adequate risk strategy that addresses identified risks in supply chain management, performance reporting as well as non-compliances with laws and regulations.
52. The effectiveness of the audit committee and internal audit's role as an assurance provider was compromised by management's inability to adequately address and react to internal audit's findings and recommendations, mainly due to the lack of capacity at senior management level within the municipality.

## **Other reports**

53. I draw attention to the following engagements that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of these engagements that are in progress.

## Investigations

54. In the prior year, an independent consulting firm was appointed by the Premier of the province. The investigation was initiated based on an allegation of possible financial mismanagement at the municipality. The investigation is still on-going at date of this report.

*Auditor-General*

Potchefstroom

30 November 2016



AUDITOR - GENERAL  
SOUTH AFRICA

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